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SUBJECT: FINANCE MINISTER TREMONTI AND THE "CHINA THREAT"

REF: ROME 2853

1. Summary: The weakness of export markets and a perceived loss of Italian competitiveness have fueled a summer-long debate in Italy on the "trade threat" posed by China. The debate, led by Finance Minister Giulio Tremonti and his close ally, Northern League leader Umberto Bossi, has highlighted allegedly "unfair" Chinese trade policies. Promptly disavowed by the PM and the other parties of the GOI majority, the debate did not affect Italian positions at the Cancun Ministerial. Tremonti did, however, raise it again at the informal EcoFin meeting in Stresa, and intends to raise the issue at the September 20th G7 finance ministers, meeting in Dubai. In the interest of business trade and investment relations with China, other elements in the GOI are working to calm the polemics. End Summary.

Poor performance of Italian exports

2. Italian exports have done poorly during 2003. According to the latest ISTAT CIF/FOB statistics, exports decreased by 2.8 percent in the period January-June 2003 over the corresponding period in 2002, while imports increased by 2.3 percent over the corresponding period in 2002. These trends produced a E4.3 billion trade deficit in the first half of 2003, compared to a E2.3 billion surplus in the comparable period in 2002. The worsening of the trade balance also negatively affected the current account deficit, which reached E14.5 billion at the end of the period January-June 2003, more than twice the deficit of E6.3 billion registered at the end of June 2002. The weakness of Italian exports and the loss of competitiveness are serious problems for an export-led country where exports account for 25 percent of GDP. According to both government and industry economists, the lack of investment in technology has reduced the competitiveness of Italian exports and aggravated their sensitivity to exchange rate fluctuations. In addition, Italian exports were hit by the euro's appreciation against the dollar in the first eight months of this year.

Summer debate on the "Chinese threat"

3. Italy's exports to China dropped by 39.9 percent from July 2003 to July 2002, and Italy's imports from China increased by 12.7 percent during this period. For the seven months through July 2003, Italian exports to China decreased 6.3 percent, while imports from China increased by 18.2 percent, producing a E3.6 billion trade deficit. Italy's trade deficit with China has worsened each year from 1998 to 2002, rising from E2.5 billion to E4.3 billion. During the same period, however, two-way trade more than doubled from E6.1 billion to E12.3 billion.

4. In mid-August, Northern League leader Umberto Bossi, a junior member of the GOI coalition and Minister of Institutional Reforms, called for "appropriate measures" to be taken against Chinese products to defend Italian exports. He spoke of implementing customs duties on behalf of small northern Italian entrepreneurs, the core of his political electorate, who are potentially threatened by the allegedly aggressive Chinese trade policy. The following day, PM Berlusconi and Deputy Minister Urso disavowed Bossi, maintaining that WTO agreements do not permit the EU to impose additional customs duties against China. Note: There are 61 antidumping customs duties currently imposed on non-EU production, 32 of which apply to Chinese products. End Note.

5. Subsequently, Finance Minister Tremonti stated several times that the EU should implement appropriate measures to defend not only Italian and EU production, but the industries of all developed western countries, against the Chinese threat and to ensure "rules based trade." In an

interview with popular magazine Panorama, (and promptly

echoed by the Italian dailies) Tremonti recommended that "Europe should do what America, the home of free-trade, has long done successfully. In other words, protect the domestic market and national production, not only with customs duties, but also through indirect measures, such as food safety, health, environmental and labor standards, to control the entry of products from the Far East."

16. In the Panorama interview Tremonti also raised Chinese intellectual property rights violations, such as the "CE" (China Exports) seal put on Chinese exports, which appears identical to the European Union "CE" seal put on products manufactured according to EU labor, health and environmental regulations. Tremonti charged that the similarity of the two seals creates intentional confusion for consumers. He also expressed serious concern that aggressive (and unfair) Chinese competition would not stop at mature and low technology products, but soon would hit high technology goods and services that are now the monopoly of advanced western economies. Comment: In the interview Tremonti ignored the role that Italy's lack of investment in research and development has played in the decline in competitiveness of Italian exports, preferring instead to focus on foreign) and particularly Chinese) competitive practices. End Comment.

Italy's official position

17. On August 26 Carlo Monticelli, Senior Director in the Finance Ministry's international department in charge of the EU presidency, told Emboffs that Tremonti would not officially include in the agenda of the September 12-13 EcoFin meeting in Stresa any specific issue regarding China. Nonetheless, we understand that China's currency value was, in fact, debated at the informal ECOFIN, reported SEPTEL. Tremonti has asked various experts to analyze the "Chinese problem" and its effects, and Monticelli said that Tremonti would likely raise this issue when G7 Finance Ministers assemble prior to the annual IMF/World Bank meetings in Dubai on September 23-24. He said that China's unfair trade practices had already been discussed in a G7 forum (specifically citing a G7 meeting in France in February). Moreover, Monticelli argued that other G7 member countries are interested in this issue.

18. Monticelli's statements, however, stand in contrast to the negative reactions to the Tremonti proposal elsewhere within the Italian Government and with some other EU governments and the Commission. EU Trade Commissioner Lamy,s spokesperson has denied that, at the EU level, there exists a case against China for "unfair competition." At the GOI level, PM Berlusconi is expected to visit China at the end of October, during Italy's EU presidency, and he is expected to sign an agreement on tourism. Approximately 100 million Chinese are estimated to have the financial resources to visit Europe, and Italy is considered a popular destination. In November, a bilateral EU-China trade summit is scheduled in Taormina, Italy -- foreign direct investment flows will be a theme, with the aim of increasing both European investment in China and Chinese investment in Europe.

19. Comment: Despite the negative trends in bilateral trade flows and the Italian media hype, the "Chinese threat" raised by Tremonti has not captured the support of the governing coalition as a whole. At the moment it appears to be merely a personal view, albeit one held by Italy,s most important economic official, and by Northern League head Bossi (reported Milan SEPTEL). Given the complexity and the scope of the Chinese-Italian relationship, the official GOI position leans toward a positive approach to China in order to avoid retaliation. Several Italian companies invest and produce directly in China, and a protectionist crusade with DEPT FOR EUR/WE, EUR/ERA, EB/IFB/OMA
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the imposition of customs duties on Chinese products would adversely affect Italian companies operating in China. Nevertheless, it is likely that at the Dubai G7 meeting Tremonti will raise his personal views. He might call for adoption by China and other developing countries of environmental and social standards generally accepted by western countries. End Comment.

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